

[Packaged Facts Column for Petfood Industry/2nd Quarter]

The Right Place at the Right Time

The terms “recession-proof” and “recession-resistant” are often applied to the pet products market, and it now appears that “disaster-resistant” may be added to the list. Following the biggest petfood recall in history, the North American market has snapped back by most measures, with both retail sales and levels of new product introductions exceeding their pre-recall levels as we move toward the middle of 2008.

This is not to say that everything is peaches and cream in the petfood market during these touch and go economic times. During the 52 weeks ending April 20, 2008, sales of dog food in the mass-market outlets tracked by Information Resources, Inc. (supermarkets, drugstores and mass merchandisers except Wal-Mart) rose just 2.5%—not exactly a stellar showing, and even less so given that poundage declined by this same amount. On the cat food side, dollar sales rose 3.2% while volume sales fell 4.1%. These figures clearly illustrate that dollar sales gains are coming from higher prices rather than incremental growth—perhaps no big surprise since this has been the case for quite some time. What may be surprising is just how quickly and steadily prices have been going up, especially during the past five years.

Trends in consumer price indexes bear out the fact that US consumers are paying more for petfood than ever before. According to the US Bureau of Labor Statistics, the consumer price index for petfood has risen 25% from 1998 to 2008, with the large majority of this increase having taken place since 2003. Although some manufacturers claim that they’ve been absorbing the higher production costs, government data show that those increases have in fact been passed on to consumers almost point by point, with the producer price index for petfood having risen 26% during the ten-year period.

Moreover, with no end to high energy costs in sight, and with petfood increasingly competing with human food for ingredients (especially in the fresh, organics and “human-grade” arenas), production costs can be expected to continue to increase for the foreseeable future. Add to those trends the ongoing industry focus on ingredients sourcing and traceability spurred by the recall, and one can rest assured that, recession or no, petfood prices are going to continue to go up.

What does this mean for the millions of pet owners trying to put food on the table (or floor) for Whiskers and Fido? Well, in the case of the premium demographics many companies now consider their base—those Americans with high household incomes and intense pets-as-family proclivities—the truth is it may not mean that much. These are the pet owners least likely to feel the economic pinch or, even if they do, to cut back on indulging their “kids” with the healthiest foods possible seemingly regardless of cost.

In sharp contrast, a fair number economically challenged consumers—those who were barely getting by even before gas prices skyrocketed and the housing market tanked—may drop out of the pet market altogether, at least temporarily. Already, dozens of shelters nationwide have reported a spike in consumers dropping off pets because they can no longer afford the basics of caring for them. The Kentucky Humane Society has, for example, seen a 140% increase in drop-offs year to date (as of May 2008) compared to last year, the majority of which are directly finance-related. In northern California, a reported “massive increase” in dogs coming into shelters is due in part to people losing their homes to foreclosure.

That leaves all of those consumers in the economic middle, who still comprise a majority of the US population (regardless of what Lou Dobbs may have to say about it) as well as a majority of dog and cat owners. In the post petfood recall world, some of these consumers probably switched to higher priced foods, but as the going gets tougher, at least as many may be looking anew at more moderately priced options.

As a result, certain value-positioned products stand to gain, especially those putting a fresh/natural spin on pet nutrition. A prime example is Mars’ Goodlife Recipe, which was launched only a few months before the spring 2007 recall, and whose dry dog food and treats chalked up sales of \$15.3 million during the first two quarters of that year, according to IRI. During the 52 weeks ending April 20, 2008, sales rose 365%.

Yes, it’s Mars, which has the luxury of producing Goodlife in the Doane Pet Care plant it acquired in 2006. And yes, this new petfood brand has been backed by a huge introductory marketing spend. Perhaps even more important, though, is Goodlife’s pricing strategy. Commenting on the launch, a company spokesperson informed *Promo* magazine (December 16, 2006), “Customers told us they wanted higher-quality food options at an affordable price.” With a positioning like this, it’s no wonder that Goodlife took off at the height of the recall and

it will be no wonder if—as this column predicts—it will also be one of the big “more for less” petfood winners as middle-market pet owners continue to tighten their belts.